# Nature and Structure of Markets

## Meaning of Market

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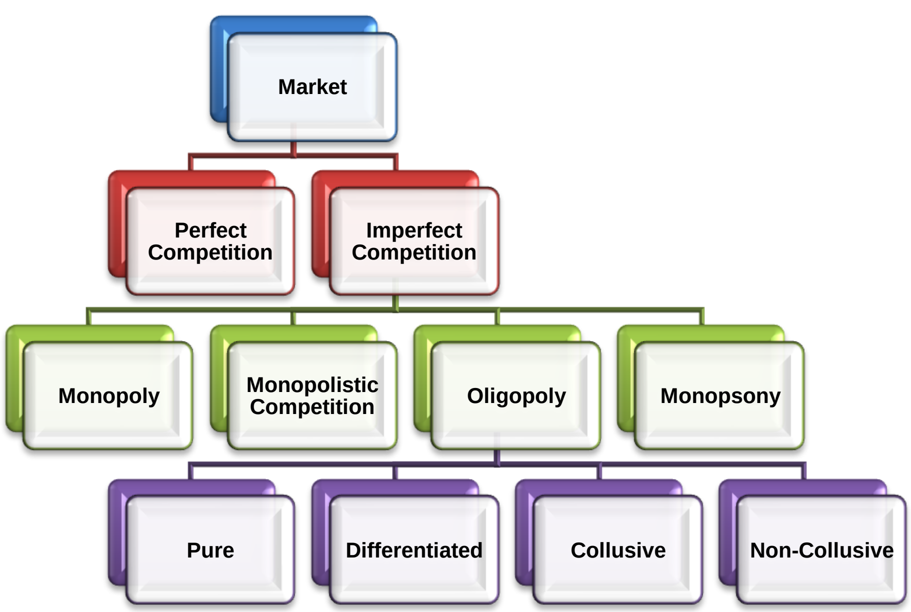
Market refers to a mechanism or an arrangement which facilitates contact between buyers and sellers for sale and purchase of goods and services.

### Various Forms of Market Structure

A market structure refers to the number of firms operating in the industry, nature of competition between them and nature of the product. Factors determining market structure:

- Number of buyers and sellers: Its significance lies in the fact whether a buyer or a seller by her/his own independent action influences the price of the commodity in the market.
- Nature of commodity: The prices of homogeneous and standardised commodities will be the same, whereas the prices of differentiated commodities of different sellers of the same commodity will be different.
- Mobility of goods and services: The freedom of movement of goods and factors of production enable sellers to charge the same prices.
- Perfect knowledge: Uniform price of the commodity will emerge because buyers and sellers of a commodity have perfect knowledge about prices and costs in different parts of the market.

On the basis of the given factors, there are two main forms of market. They are



## Perfect Competition

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Perfect competition is a form of market where there are a large number of buyers and sellers of a commodity. A homogeneous product is sold in the market. An individual firm has no control over the price. It is a price taker.

## Features of Perfect Competition

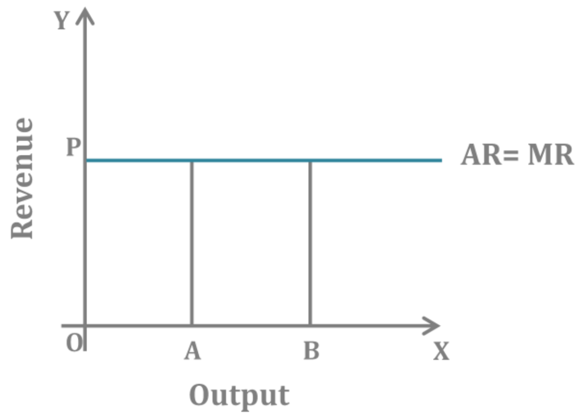
- Large number of sellers and buyers: The number of firms selling a particular commodity is so large that any increase or decrease in supply by an individual firm hardly impacts the total supply. So, an individual firm fails to impact the price of the commodity in the market. It can sell any amount at the existing price of the commodity. Hence, a firm under perfect competition is a price taker. Even the number of buyers is large, and hence, an individual buyer is also unable to influence the price of the commodity.
- Homogeneous products: All sellers sell identical units of a product. The existence of identical products implies the same price for the product in a competitive market. Hence, buyers have no reason to prefer the product of one seller compared to that of another.
- Free entry and exit of firms: A firm can easily enter and exit any industry as there is no legal restriction. Whenever there are abnormal profits, new firms will enter the industry and whenever there are losses, few existing firms will exit the industry. This situation is possible only in the long run.
- Perfect knowledge: Buyers are aware of the price prevailing in the market. Also, they are aware that the homogeneous product is being sold by all the firms at uniform price.
- Perfect mobility: Factors of production are perfectly mobile. They will move to that industry where they get the best price.
- Absence of selling cost: Selling costs are the costs incurred by a firm to promote its sale. The seller can sell any amount of commodity at the existing price, and hence, selling costs are not required.
- No transport cost: For one price to prevail throughout the market, it is essential that there is no extra transport cost for consumers while buying a commodity from the sellers.

### A Firm under Perfect Competition is a Price Taker not a Price Maker

Under perfect competition, there are a large number of firms producing homogeneous commodities. In this market condition, an individual firm cannot change the price of the commodity. Price is determined by the forces of market demand and supply. All the firms in the industry sell their output at the given price. Hence, a firm under perfect competition is a price taker.

### Demand Curve of a Firm under Perfect Competition

Demand curve of the firm under perfect competition is perfectly elastic. It means that the firm can sell any amount of the commodity at the prevailing price. A firm’s demand curve is indicated by a horizontal line parallel to the X-axis. This shows that the firm is to accept the price as determined by the forces of market supply and market demand.




The diagram shows that at the given price level OP, the firm can sell any quantity of the commodity it produces. Price remains constant whether the quantity demanded is OA or OB or even zero.

## Monopoly

Monopoly is a form of market where there is a single seller of a good with no close substitutes.

## Features of Monopoly

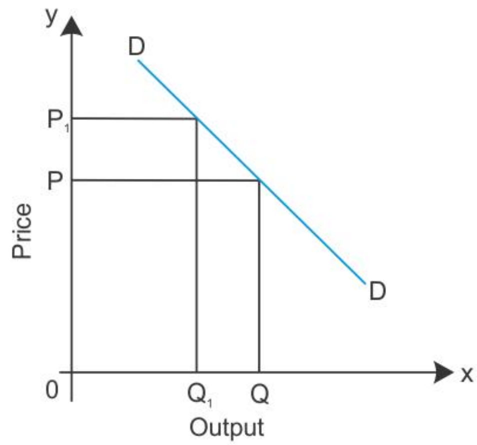
- There is a single seller and a large number of buyers of the commodity.
- There are some restrictions on the entry of new firms into the monopoly industry. Generally, there are patent rights or exclusive control over a technique or raw material.
- They produce a commodity which has no close substitutes. Hence, there will not be any shift in consumer preferences from one product to another.
- Being a single seller of the product, a monopolist has full control over its price. Hence, a monopolist is a price maker.
- A monopolist charges different prices from different buyers for the same product to maximise profits. This is called price discrimination.
- The firm does not spend much on advertisements. It incurs only nominal selling costs in the beginning just to give information to buyers about its product.

**Negatively Sloped Demand Curve**

Full control over price under monopoly does not mean that the monopolist can sell any amount of goods at any price. Once the price is fixed by monopolists, consumers decide the quantum of the good to buy. The market demand curve of the monopoly firm shows that the consumer is willing to buy more at lower prices. On the other hand, when the prices are more, the consumer buys lesser quantity. There is an inverse relationship between the price and the quantity sold by a monopoly firm. Thus, the demand curve of a monopoly firm is a downward sloping curve.

**Demand Curve for a Monopoly Firm**

The curve shows an inverse relationship between price and quantity. Thus, $OQ_1$ quantity is sold when the price is $OP_1$. When the price is reduced from $OP_1$ to OP, the quantity sold by the monopolist rises from $OQ_1$ to OQ.




## Monopolistic Competition

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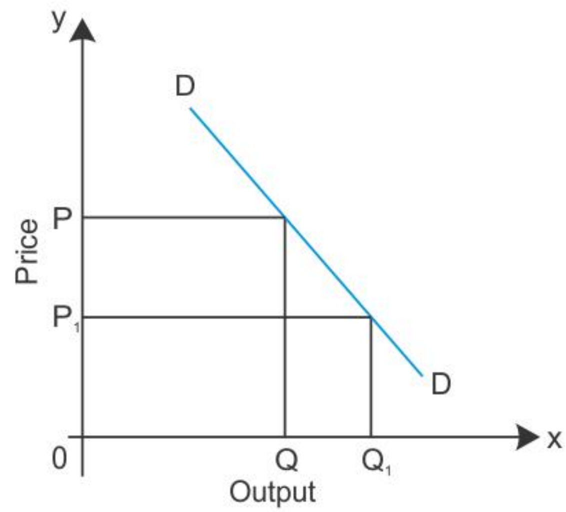
Monopolistic competition is a form of market in which there are many sellers of the product, but the product of each seller is different from the other.
A monopolistic firm has partial control over price only through product differentiation. Products are differentiated through designs and colour of packing of the product. It attracts consumers to buy the product at a higher price. As there are many rivals and close substitutes of products in the market, a monopolistic firm cannot have full control over the price.

## Features of Monopolistic Competition

- Under monopolistic competition, different producers try to differentiate their product in its shape, packing and brand name. This is done to attract buyers from rival firms in the market. This is called product differentiation.
- There is a large number of sellers and buyers. The size of each firm under monopolistic competition is small. Each firm has limited share of the market.
- Firms are free to enter the industry and exit it. However, new firms have no absolute freedom of entry into the industry. Some firms have patent rights for a product. New firms cannot produce those products.
- Each firm has to incur selling costs on advertisements to promote its sales. This is because there is a large number of close substitutes in the market.
- Sellers and buyers of products do not have perfect knowledge about the market price. Because of product differentiation, it is not possible to compare the price of different products.

**Nature of Demand Curve**

Under monopolistic competition, the firm has a negatively sloped demand curve which is more elastic. A large quantity of the product can be sold by reducing its price. It is more elastic than the demand curve of a monopoly firm because of close substitutes available in the market. In the demand curve 'D' of a firm under monopolistic competition, the slope indicates high elasticity of demand for the product.




## Oligopoly

In an oligopoly market, each firm is huge enough to control a significant portion of the market. Output quotas and the price have a direct bearing on the output and the price of rival firms in the market. So, there is no unique demand curve for an oligopoly firm. They form a collusive agreement among the firms to fix the price and output in the market. It is to avoid price competition and earn monopoly profits.

As there is a high degree of interdependence between the firms, the firms demand curve is indeterminate under oligopoly. Price and output policy of one firm have significant impact on those of the rival firm in the market. It is hard to estimate change in a firm’s sales caused by a change in the price. A clear relationship between the price and the sales cannot be established in the market.

**Types of Oligopoly**

- Pure oligopoly: Pure oligopoly is a form of the market in which the products of the firms are homogeneous.
- Differentiated oligopoly: Differentiated oligopoly is a form of the market in which the products of different firms are different but are close substitutes of each other.
- Collusive oligopoly: Collusive oligopoly is a form of market in which few firms form a mutual agreement to avoid competition. They form a cartel and fix the output quotas and the market price. The leading firm in the market is accepted by the cartel as a price leader. All the firms in the cartel accept the price as fixed by the price leader.
- Non-collusive oligopoly: Non-collusive oligopoly is a form of market in which there are a few firms in the market. Each firm has its price and output policy independent of the rival firms in the market. All the firms are able to increase their market share through competition in the market.

## Monopsony

Monopsony refers to a market where there is a single buyer of a commodity or service but there are many sellers. The monopsonist is capable of influencing the supply price of his purchases by the amount he buys. He can bring down the price of the product or factor service by reducing the quantity of purchases. However, he purchases more quantities of the product and so has to pay more. He regulates his purchases in a way that marginal costs equal marginal utility.